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UNCLAS SECTION 01 OF 02 THE HAGUE 000814

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SUBJECT: BAIL-OUT OF DUTCH-BELGIAN BANKING GIANT FORTIS

THE HAGUE 00000814 001.2 OF 002

¶1. (SBU) Summary: Following a weekend of intense negotiations, Fortis Bank announced September 29 that the governments of the Netherlands, Belgium, and Luxembourg will invest a total of EUR 11.2 billion in return for a 49 percent share in the bank's institutions in each country. While the U.S. financial crisis - including the presence of U.S. mortgage-backed securities on Fortis' books and a global loss of consumer confidence - precipitated the current crisis, Fortis already was in trouble after its overpriced purchase of Dutch bank ABN AMRO in October 2007. Dutch experts are watching closely for signs of other troubled companies, but for now they remain hopeful that the Fortis bailout will not undermine other financial institutions or consumer confidence in the relatively healthy Dutch economy. End summary.

¶2. (U) Fortis Bank, the Belgian-Dutch banking and insurance giant, will receive a capital injection of EUR 11.2 billion from the governments of the Netherlands, Belgium, and Luxembourg to prevent its impending collapse. In a deal brokered in the early morning hours of September 29, each government will receive a 49 percent ownership share in Fortis' operations in that country. The Dutch government will invest EUR 4.0 billion for a 49 percent share of Fortis Bank Nederland; the Belgian government will invest EUR 4.7 billion for a stake in Fortis Bank NV/SA Belgium; and the Luxembourg government will invest EUR 2.5 billion in Fortis Banque Luxembourg SA. While details of the deal are still pending, Dutch Finance Minister Wouter Bos said the Dutch government will hold the Fortis shares until it can sell them at a more opportune time in the future. The state-sponsored rescue followed intense negotiations over the weekend of concerned finance ministers, central bank officials, and banking executives to shore up confidence in the embattled banking giant. Dutch stock market reaction was highly volatile on September 29; Fortis shares were up 14 percent in the morning but down 13 percent in the afternoon before close of business.

¶3. (U) The capital injection will give Fortis time to sell off its units in a controlled manner, including its interests in Dutch bank ABN AMRO. Fortis joined with Royal Bank of Scotland and Banco Santander of Spain in October 2007 to break up ABN AMRO; Fortis acquired the Dutch bank's retail and private banking operations in the Netherlands for EUR 4 billion amid a national furor that a cornerstone of the Dutch financial sector had been acquired by a foreign consortium. Dutch insurance giant ING, which was rumored to be interested in purchasing Fortis' ABN AMRO holdings if it could overcome EU competition concerns, has again expressed interest in buying the Dutch entity, but it had made no formal offer as of September 29. As opposed to the hefty price that Fortis

paid for its ABN AMRO stake in 2007, some Dutch media report that Fortis could accept as little as EUR 10 billion this week for its ABN AMRO holdings.

¶4. (U) The collapse of Fortis' share price - from a high of almost EUR 30 in October 2007 to EUR 5.18 on September 26 - prompted Dutch, Belgian, and Luxembourg governments to rescue Fortis before markets re-opened on September 29. Bankers and policy makers feared that failure to shore up Fortis could lead to a broader loss of confidence in other European financial institutions. Struggling with lagging investor Qfinancial institutions. Struggling with lagging investor confidence and a steady drop in share price throughout 2008, Fortis' plan had been to sell its non-core activities, but it could not find buyers in the short term. French bank BNP Paribas was also considering a wholesale purchase of Fortis, but no deal could be reached. Now that Fortis has been buttressed by government capital, potential buyers may come forth to take advantage of what amounts to a fire sale of Fortis assets at bargain prices. BNP Paribas, ING and others reportedly are considering purchasing some or all of Fortis' holdings, although firm offers have yet to be announced.

¶5. (U) While many blame the spillover of the U.S. financial crisis into European markets for Fortis' demise, other factors played a major role. Perhaps the key reason was the bloated price of EUR 24 billion that Fortis paid in October 2007 for its ABN AMRO acquisitions. Fortis agreed to the overpriced deal because it transformed the then-medium-sized Belgian-Dutch firm into one of the largest financial institutions in northern Europe. Fortis made this purchase just as the extent of the U.S. financial crisis began to surface. Concerns about Fortis absorbing ABN AMRO's assets while simultaneously grappling with a large portfolio of U.S. mortgage-backed securities undermined investor confidence and set Fortis' share price on a steady decline throughout 2008.

Fortis announced losses due to its sub-prime investments of EUR 2.7 billion in 2007, followed by additional write-downs of EUR 380 million in the first quarter of 2008 and EUR 362 million in the second quarter. Several subsequent developments led to rumors that the bank faced a serious liquidity shortage, including Fortis' announcement in June of the cancellation of its interim shareholder dividend. Meanwhile, Fortis had sold its ABN AMRO Asset Management division to Chinese bank Ping An in March 2008 for EUR 2.15 billion, but Fortis has yet to receive that payment due to the reported reluctance of the Chinese government to allow the completion of the sale. In August 2008, Rabobank announced that many former Fortis customers were switching their savings accounts to Rabobank due to lack of confidence in Fortis' liquidity. These developments have produced a steady decline over the past few months in Fortis' share price. Policy makers decided to intervene over the weekend to prevent what they saw as Fortis' impending collapse when markets opened on September 29.

¶6. (SBU) Comment: Fortis is the largest Benelux financial institution thus far to be hit by the same crisis of confidence that has undermined leading U.S. financial institutions. While the U.S. financial crisis - including the presence of U.S. mortgage-backed securities on Fortis' books and a global loss of consumer confidence - precipitated the current crisis, Fortis already was in trouble after its overpriced purchase last year of ABN AMRO. Public debate in the Netherlands, as in the United States, already is underway about whether governments should use taxpayer money to bail out irresponsible financial institutions. Nonetheless, Embassy contacts at the Dutch Central Bank, Rabobank, and ING tell us that policy makers had little choice but to intervene to prevent Fortis' collapse and the likely spillover into other Dutch financial institutions it could have produced. Rabobank and ING assert that their balance sheets are healthy, that they carry few U.S. mortgage-backed assets, and that they are in no danger of succumbing to Fortis' fate.

(Note: Further reporting on the health of the Dutch financial sector will follow septel. End note.) Dutch financial leaders and policy makers are looking closely for further signs of financial crisis, but for now they are hopeful that the Fortis bailout will not undermine other financial institutions or consumer confidence in the relatively healthy Dutch economy. End comment.

Culbertson